DOW THEORY LETTERS INC.

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36 Letters per Year — $75 Annually

Registered with the Securities Exchange Commission

July 19, 1972 Letter 535

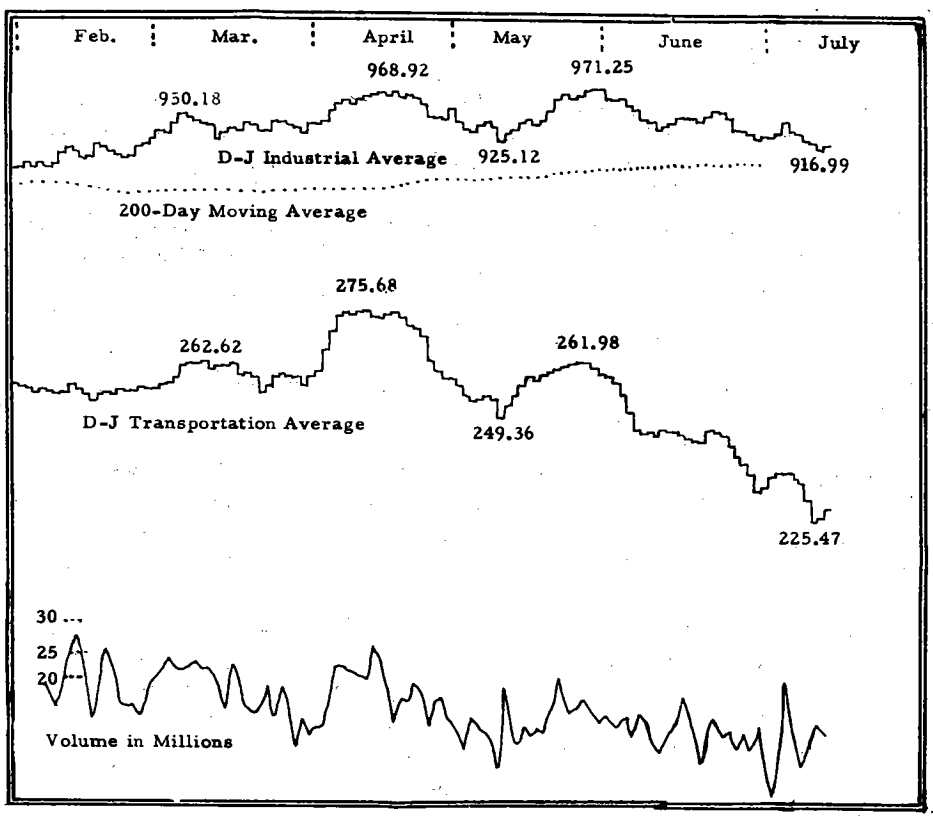
THE MARKET: This is one of those areas where it is particularly instructive to follow the implications of the Averages under Dow Theory. One of the basic tenets of Dow's Theory is that in order for a movement to be valid, both Averages (Industrials and Transports) must confirm each other by jointly penetrating preceding rally or decline points. There is no definite time limit placed on the confirmation principle, but as a rule the closer (in time) the penetrations, the more important the confirmation. Penetrations by the two Averages which take place simultaneously (on the same day) are generally conceded to have the best forecasting authority.

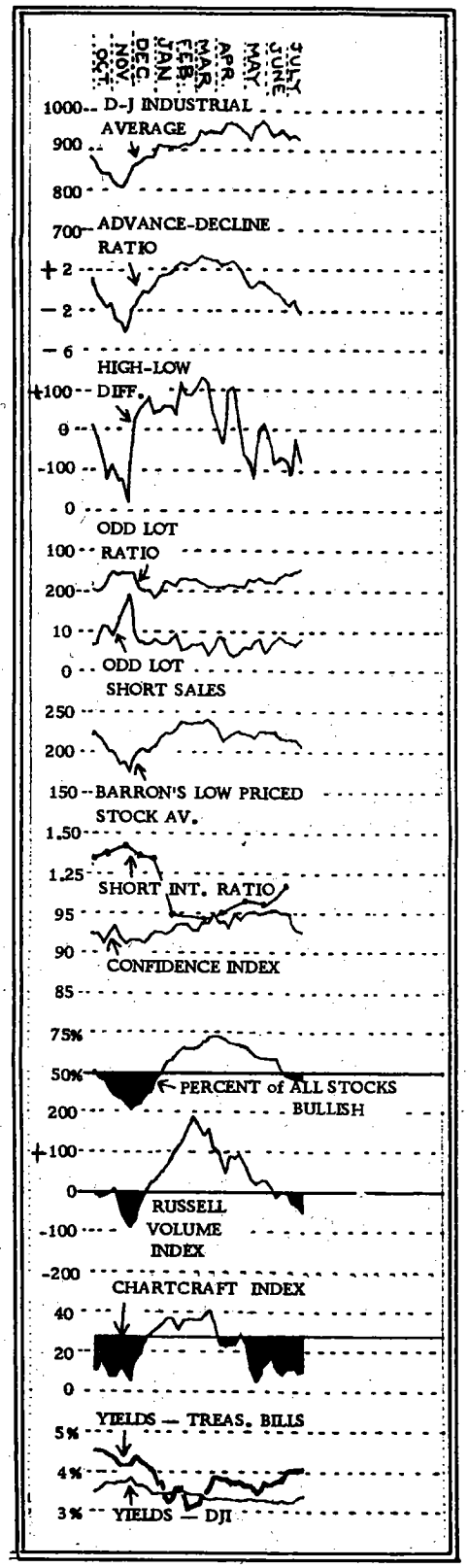
Referring to the page 1 chart, we note that the two Averages recorded 1972 recovery highs in mid-April, the Transports at 275.85 (April 12) and the Industrials at 968.92 (April 28). A decline carried to May 9 lows of 925.12 on Industrials and 249.36 on Transports.

Another advance then got underway. By May 26 Industrials had climbed to a 1972 peak of 971.25, but Transports turned sluggish. They failed by 14 points to better their own 1972 peak of 275.85. This was the first serious non-confirmation of 1972.

From the late-May peak the Averages turned down, and on June 6 the Transports broke below their May 9 lows. Here the Industrials failed to confirm. For the next month the Industrials fought against a downside confirmation, and for this reason I directed the attention of subscribers to the important May 9 Industrial level of 925.12. This level, I felt, was the critical technical point in the structure of the Averages.

On July 12, following a rally which faded out, Industrials sank below the 925.12 level to close at 923.69. This confirming penetration occurred 25 trading days after the Transports penetration of their own May 9 lows, although Volume picked up to 16 million shares as the Industrials went through. All of which raises the question of the importance of the breaking of the May lows.





 This is the way I see it. The movement certainly would have had more authority and power if the May 9 lows had been violated by both Averages simultaneously, rather than 25 trading days apart. The Industrial penetration of July 12 came following a long spate of very poor market action (the advance-decline ratio was already at new 1972 lows), and to some extent the market was "oversold." This could prevent early and heavy liquidation (which had already taken place), and could even set up the technical base for a late-July or early August rally. But these are merely temporary arguments for the bulls.

My thesis has all along been that we are in a primary bear market and have been since February, 1966. The July 12 Industrials penetration of the May lows has "wrecked" the price structure in that it has completed the huge 1972 top and it has provided a bearish signal under Dow Theory.

The Industrials have now confirmed the prior bearish implications of the Transportation Average, the Utility Average, the advance-decline ratio. Many technical indicators such as the Dow short interest ratio, secondary distribution, odd Lots, high-lows, Russell volume index, Chartcraft composite index, Confidence Index, suggest that the market is in poor shape. In view of this negative technical background, I feel the confirming penetration of the Industrial Average (July 12) should be taken most seriously. In other words, the technical background of the market has been poor; the price structure is now also in tatters.

In reading dozens of advisory services, I note that many (if not most) advisors speak with an air of "authority" which is intended to suggest that they "know" with a God-given certainty the near-term direction of the market. These advisors seem to feel that their publications will be more salable if they play the part of the prophet. Veteran market students know that there is no certainty on Wall Street, and they tend to avoid those analysts who offer what no man has a right to offer. I note that the older advisory services always tread gently, and they allow for the ancient but totally factual aphorism that "the market can do anything."

The most common opinion these days is that the Dow will hold above 925 (this is already discredited) or that any sell-off will hold above the 900 level. Certainly there is almost a universal sentiment to the effect that the long-term trend is up and that with the "improving economy" it is only a matter of time before "1000 on the Dow" is breeched.

I continue to believe that 995.15 (February, 1966) was the Dow's way of discounting the best that could be seen ahead. The 995.15 bull market peak has held for six years now, and I believe that we stand a good chance of witnessing vastly lower prices before the next primary bull market takes the Dow above 1000.

Technical notes: The Chartcraft percentage of all stocks in bullish trends on the NYSE has dropped to 44%. The percentage of the 30 Dow Industrial stocks in bullish trends dropped under the critical 50% level last week for the first time this year. It now stands at 43%. Bellwether General Motors, despite a 5 point rally in the Dow, closed Friday, July 15, at 73 1/8, a new low for the year. Telephone, the world's most widely distributed stock, hit a new low last week as well.

LONG-TERM ADVANCE-DECLINE LINE: (See chart, page 3). This is a study which I have not presented before, and it places the weekly advance-decline on a long-term or 30-week moving average. Thus, the lower line on the accompanying chart shows the total of all the weekly pluralities of advances and declines for a period of 30 weeks (or over half a year).

I feel that this line shows the long-term direction of any diversified portfolio of stocks on the NYSE. This is true since almost any portfolio will tend to move in the broad overall direction of the advance-decline line. For this reason, I often think of the 30-week moving average of the A-D ratio as an "investment line."

Following the 1970 lows established by the 1969-70 crash, the 30-week average of the A-D (which I will refer to as the Index) rose steadily to a plurality of over 10,000 as shown on the chart. The Index topped out in March, 1971, and this means that March of 1971 marked the peak of profitability for the whole 1970-71 rise.

From then on, it was a matter of deterioration with the Index sinking to a low of minus 7000 in November, 1971. A new advance took the Index across the zero level to the plus side in January, 1972. In early March of this year the Index hit a high of plus 3600. Since then, it has been a matter of ebbing strength. Last week (week ending July 14) the Index sank into minus territory, to its lowest level of the year.

The conclusion is that the peak of strength on the long-term A-D line was reached early in 1971. Since then, it has been a matter of gathering weakness, except for a brief three-month period in late-1971 and early-1972. As of now, the Index is bearish and negative, indicating that the majority of all NYSE issues are showing losses on average over the last six months (actually 30 weeks). Furthermore, the Index is saying that the majority of issues reached their best levels in early 1971, and any assorted portfolio of stocks held since then would now be in the minus column.

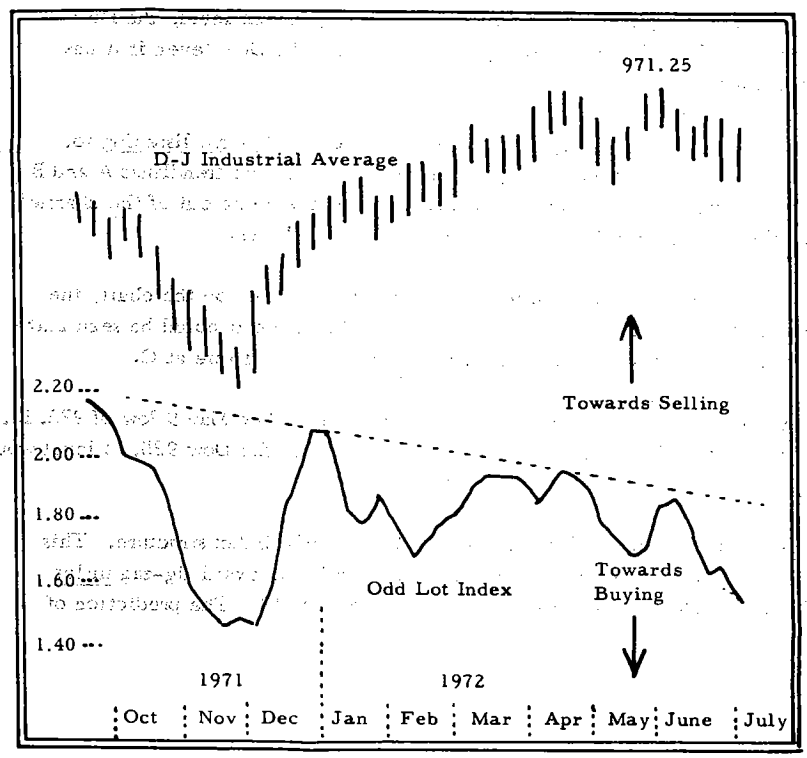
ODD LOTS: It has been quite a while since I mentioned the odd lots, but at this time the odd lot statistics are interesting enough to warrant comment. I have included a chart showing a ten-day moving average of the odd lot ratios. The ratios are simply ratio of total odd lot selling to buying. When the odd lot ratio index drops to 1.00, buying and selling are equal. Higher figures signify a trend to more selling.

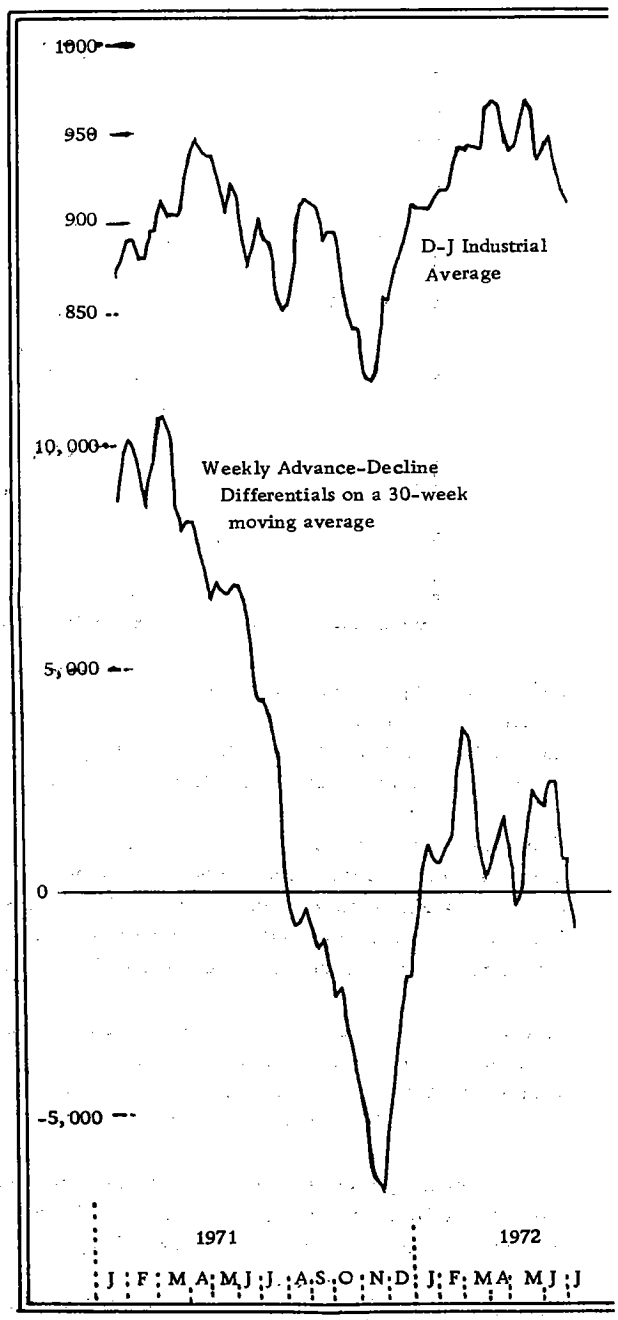
The chart shows that on a trend basis, the peak of odd lot selling in 1972 was seen in January. Since then, the index has declined with July bringing in the least selling (or the most tendency towards the buying level) seen this year. In analyzing the odd lot figures, it is important to remember that the absolute level of the ratios is not particularly important, it is the direction of the ratios, and particularly the direction of the ratio in relation to the direction of the Dow.

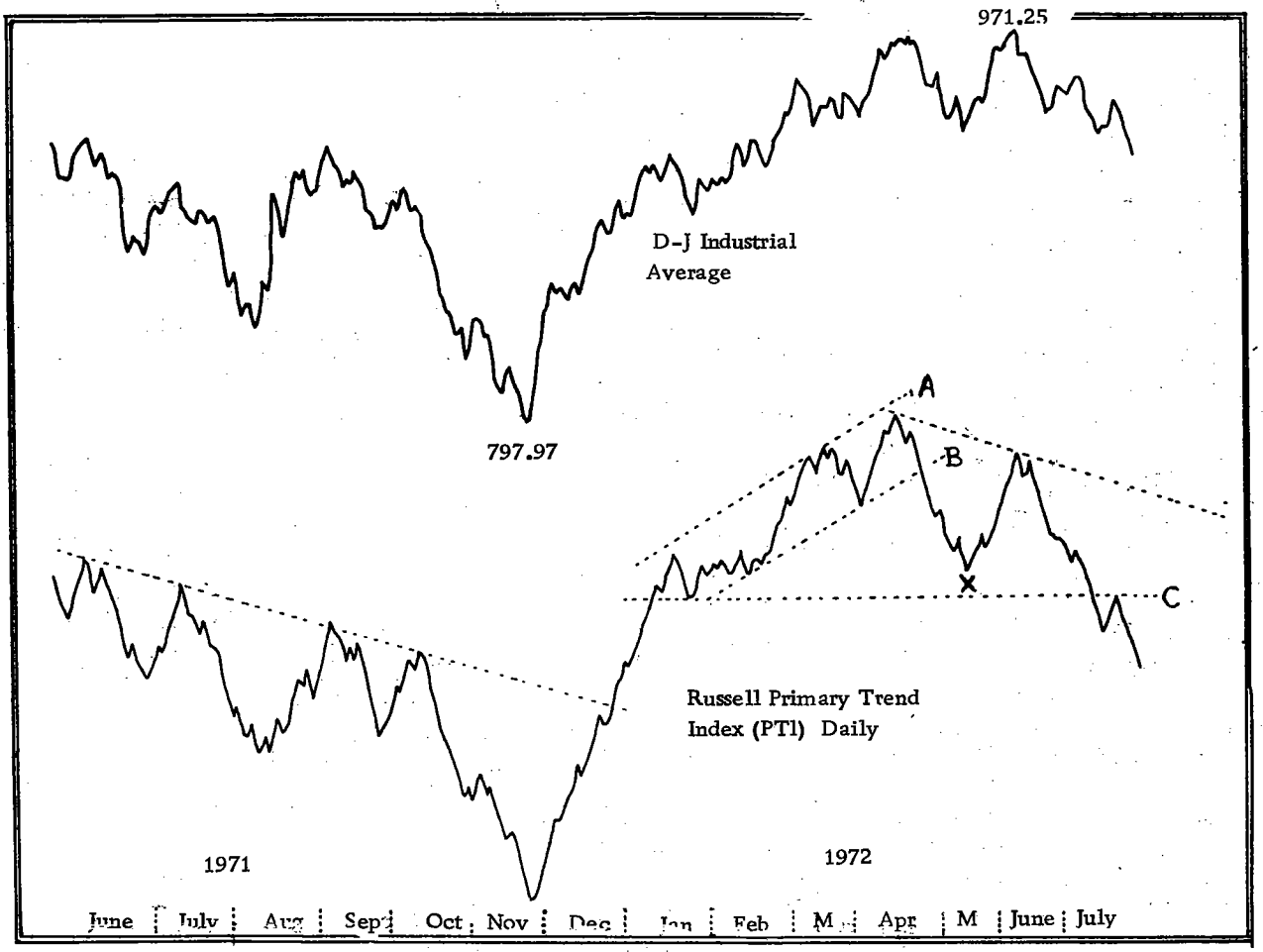
Since the Dow Industrials have literally moved sideways in a range since March of 1972, I take it that the trend of the odd lot index towards the buying level indicates that the public is gaining confidence. This is a negative technical feature of this market. In the past, the public has tended to guess the outcome of a stalemated market incorrectly. The declining (toward buy side) odd lot index indicates that the public is betting that the next major move of the market will be up. History suggests that the odd lot public are most apt to be wrong.

INDICATOR: (Chart page 4) For the past few years I have been working on a new indicator. I wanted the indicator to be something which would be technical and made up of various crucial market gauges. I also wanted it to be an indicator which I could compute daily, so that it would provide a constant check on the market.

After much thinking and testing, I developed an indicator which interests me tremendously. I have never been "secretive" before, but I feel I should not and cannot divulge the manner in which this indicator is computed. If I did that, other people would follow it, and it would soon lose its usefulness (the better the indicator, the wider the following, and the sooner it loses it effectiveness, simply because "too many cooks spoil the broth").







Suffice it to say that this indicator takes into account the daily action of the three D-J common stock Averages, the broad Standard & Poor 500 Average, the D-J 40-Bond Average, the daily advance-decline ratio, the daily new highs and new lows, and the daily most-active stocks. I have discovered a unique way to coordinate the action of all of these Averages and indices into a single Index, and I have pictured the action of that Index on the accompanying chart.

The theory behind this Index is that all eight of these components are so fundamental to market action that the majority must move together in order for any movement to be valid. So powerful are the implications of this Index that the Dow Industrials (and the market) tend to follow where the Index goes (in other words, if the Index breaks a preceding Index level, the Dow Industrials will probably violate its own corresponding level). If the Index resists a preceding point, the Dow (even if it has penetrated the corresponding point) will probably reverse directions.

Like other indices, this Index is not always saying something, but when it does talk, it seems to be well worth listening to. For instance, from January to April of this year the Index formed the distinct rising channel bordered by the trendlines A and B seen on the chart. It was in this area (April 18) that the Dow ran up to 968.92. On April 24 the Index broke out of the channel (below trendline B) to provide its first warning of 1972. The Dow promptly fell to the May 9 low of 925.12.

A new advance got under way, and here the Dow rose to a new recovery peak of 971.25 (May 26). As seen on the chart, the Index failed by a wide margin to confirm. This was the second warning given by the Index. By this time it could be seen that the Index had formed a huge "head-and-shoulders" type top. I have drawn the "neckline" or support level line at C.

On June 23 the Index broke below its May 9 low, this low (marked X on the chart) corresponded to the Dow May 9 low of 925.12. The Index's breaking of its May 9 low was the third warning signal for 1972. It was a "prediction" that the Dow 925.12 level would be broken.

Finally, on June 27, the Index dropped below trendline C, thus smashing all support for the entire 1972 Index structure. This constituted the fourth warning. A little rally took place with the Index forming a minor and bearish downward zig-zag under trendline C. On July 12 as the Index broke to another low, the Dow broke under its May 9 low of 925.12. The prediction of the Index had been accomplished.

It is of interest that the Index on July 12 dropped to its lowest reading since January 3, 1972. All of the upside action of the Index for 1972 was thereby wiped out. On January 3 the Dow Industrials closed at 889. It appears that the Index is saying that the Dow is heading for the 889 level, and it will be most interesting to see whether this prediction is carried out.

I intend to keep subscribers posted on the reading of this new Index which I will call the Primary Trend Index (PTI). Again, I must say that I regret that I cannot disclose how the PTI is tabulated, but I feel that this step will work for the good of all subscribers.

IMPLICATIONS: The real story behind the fall of the pound is emerging, and it is a rather scary one at that. The fact is that a month ago the pound sterling was considered in good shape. British foreign exchange reserves had shot up from around $2.8 billion at the end of 1970 to almost $8 billion by first quarter, 1972. Then in a few days all was chaos. In the face of renewed strike threats and a galloping rate of inflation, "everyone" decided to get out of the pound at once, and it collapsed.

As Harry Schultz puts it, "Never before has a country with so strong a position been forced to the currency wall ... All this happened within just a few days. It was one of the most frightening events observers of the international scene had ever witnessed. Do you realize that $2.6 billion moved out of London within about 36 hours? When you put this into perspective, suddenly you can't help but see the current world monetary situation is explosive to a degree that staggers the imagination. It means that no currency on earth has adequate protection any longer."

What has happened? For one thing, the Eurocurrency market has boomed from $14 billion in 1971 to $70 billion today. These funds look for safety and they look for the best yield. And this huge mountain of money will move on a scare rumor, a strike hint, a higher rate of interest or a hundred other reasons.

By way of comparison (as the Holt report notes), the reserves of all the non-Communist nations of the world is about $100 billion, and only one-third of this is gold. Thus, with a portion of the $71 billion in Eurocurrency able to bounce around like a frightened rubber ball, any nation's reserves can suddenly expand (as Britain's did), then contract just as quickly as the Eurodollars run for the hills.

The next step (as reported in the last Letter) is already happening. Exchange controls are being erected, and there is little doubt that these controls are fated to be tightened even further. Eliot Janeway notes in his latest report, "Every dollar the strong Central Banks soak up and freeze is a dollar deactivated as a source of finance for the movement of goods and services. Holding off a monetary collapse by drying up dollars will buy a bit of time against a monetary collapse, but it will weaken the world economy before the plug is pulled... Last winter's break was precipitated by the discovery that the stronger Central Banks had run out of both will and the wherewithal to go on financing the US domestic deficit."

If any doubts remained as to Europe's intentions, Common Market members on July 13 agreed not to float their currencies, and in so doing implied the exchange controls against the dollar were the wave of the future (see news clip). Implicit in this decision was the suggestion that the US is to be allowed no more trade advantages via a float (upwards) of other currencies against the dollar. The international trade war is on, and the players are finally taking off their gloves.

Thus, it is slowly and painfully dawning on Washington that there are only two options open to it in order to stave off a gathering monetary and economic crisis. The first is trade restrictions, which would be an attempt to reduce the unbelievable balance-of-trade figures which are emerging, figures worse than those which existed before the recent dollar devaluation (see news clip)! But such

Balance of Trade Worse Than Before Revaluation, Bank Says

BY HARRY ANDERSON
Times Staff Writer

One expected impact of last December's international monetary realignment — an improved U.S. trade balance—has so far been just the opposite, according to a new study done by Security Pacific National Bank, Los Angeles.

The bank points out in a report on Los Angeles-area world trade released Thursday that recent partial figures for both the nation and the Los Angeles Customs District show imports into the United States have increased their lead over exports since December.

many countries has declined, meaning a shrinking market for exports. At the same time, imports here are in greater demand because our own income is rising as we come out of a recession."

Originally, thinking was that an increased valuation of foreign currencies in relation to the U.S. dollar would quickly help turn around the American imbalance of imports over exports.

Because foreign money would be worth more and the dollar less, the thinking went other

Europeans Rule Out Money Float

BRUSSELS, Belgium (AP) — European Common Market monetary officials yesterday said they are ruling out the possibility of jointly floating their currencies — letting them seek their own levels — against the dollar in the near future.

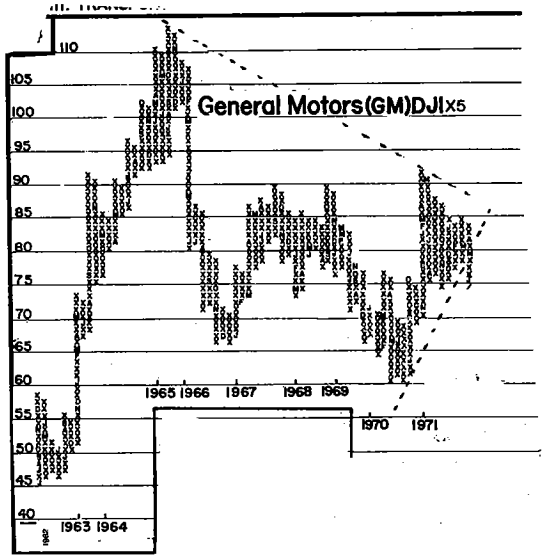
There have been rumors in foreign exchange markets that a joint float plan is in the making.

action would throw Europe and Japan into a panic, not to say a recession (with a concurrent toppling of their stock markets). The other option (which may be held off until after election) would be a major boost in the price of gold.

It is, by now, obvious to all sophisticated observers that any set of parities is totally academic unless the dollar is made truly convertible. The only way this can occur is if the dollar price of gold is subject to a major and meaningful boost, something on the order of $100 or more per ounce. Lacking such a devaluation, the dollar will continue suspect, and it will either have to go through the required devaluation or suffer increasing barriers as nation after nation seeks to phase the dollar out of its reserves.

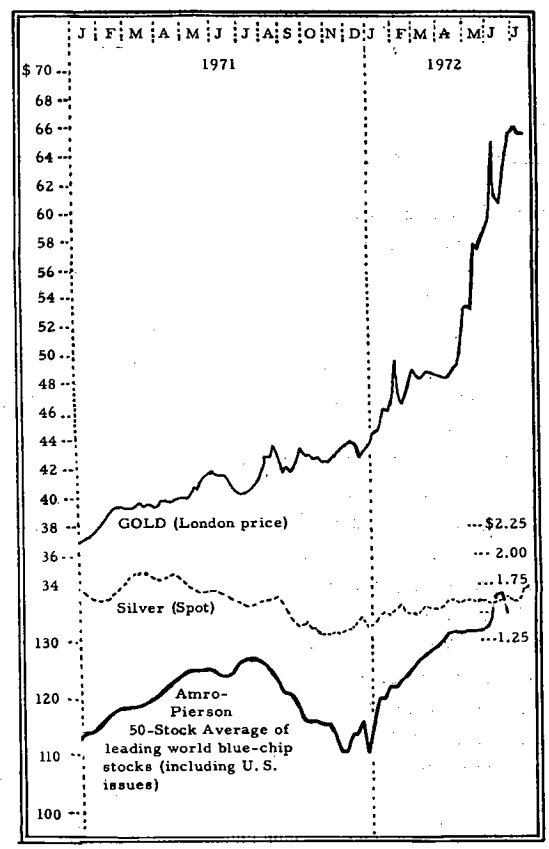
Looking at the whole monetary picture, we have the EEC monetary agreements torn apart first by the US gold embargo, then by the unexpected British float, we have the virtual collapse of the Smithsonian agreements, and now we have the rise of exchange controls. So it seems that when it becomes a question of the value of men's words, agreements and promises or the value of gold, our trust (at least at the present stage of man's moral development) must be in gold. Therefore, I would guess that in coming months more importance will be accorded gold than in further "agreements." Gold is the value, gold exerts the discipline. It has been that way for 5,000 years, and until honesty instead of greed guides the world's politicians and leaders, it would seem safe to wager that conditions will remain that way. And so — the drama of gold and the world monetary crisis moves on....

STOCKS: To the bulls, one of the most dismal signs must be the action of bellwether General Motors, which struck a new low on July 14. The accompanying point & figure chart (courtesy of Crosschart, 18 E. 41 St., NYC, NY 10017) shows the long descent of GM from 113 in 1965 down to 60 in 1970. Since then a rally built up the most recent "triangle" formation. But that penetration was just broken up on the downside over the past few weeks, and I have drawn the 1970-71 rising trendline and the violation of that trendline.



From the technical standpoint, it doesn't much matter what is wrong in GM. Suffice it to say that America's greatest manufacturing enterprise has given a bearish signal, and the trend of this stock is now undeniably down.

GOLD, SILVER: Meanwhile, the bullion price of gold has moved up to within a fraction of its closing London high (in the $56 area), while silver has at last shown signs of strength. Incidentally, those who purchased the Sunshine Mining Convertibles as suggested in Letter 532 now have about 5-7 points under their belts. These bonds have acted quite well, along with the recent firming up in silver equities, but I believe they are out of "my" buying range at today's price. In other words, if you did not buy them at around 80 when recommended, you should probably leave them alone now.



NOTE: I guess there have never been so many questions in the minds of Americans because I have never received so many letters. I cannot answer most of these letters, but I particularly appreciate all information and news clips which are sent.

About the coming election, I can only say that I have mixed feelings about both candidates. I do not believe that President Nixon has any real convictions, or if he does they never influence his politics. In other words, I cannot trust him. As to McGovern, I feel that I can trust him, but I do not believe his convictions are sound! I feel the danger here is that he is probably very ignorant regarding economics and finance, and as to his international views, I have not heard them. Many people discount McGovern's chances of winning. I do not. The fact is that people are fed up about a great many things, and whatever else you may say about McGovern, he represents "the reform candidate."